Update:
Spending Policy
Strategic Objectives

Summary of work done by the Endowment Fund Investment Board at its January 15, 2008 meeting

Mission of State Endowments:
Provide a perpetual stream of income by:

- Maximizing total return over time at a prudent level of risk
- Protecting future generations' purchasing power
- Providing a relatively stable and predictable payout

The components of this mission are sometimes at odds, requiring the Land Board to evaluate tradeoffs and establish a balance

Source: State Land Board Asset Management Guidelines

Examining Spending Policy

- Each August, the Land Board approves the amount to be distributed from each endowment fund. The EFIB provides a recommendation on this amount.
- Since 2000, Spending Policy has usually been expressed as a percentage of the Permanent Fund, and, in the last two years, has been set at 5% for most funds and 4.1% for two funds (Penitentiary and School of Science)
- The EFIB has been examining options and enhancements for Spending Policy for the last two years. More work remains to be done, but at its January 15, 2008 meeting, the EFIB approved some Strategic Objectives

In developing the Strategic Objectives, the EFIB considered several issues

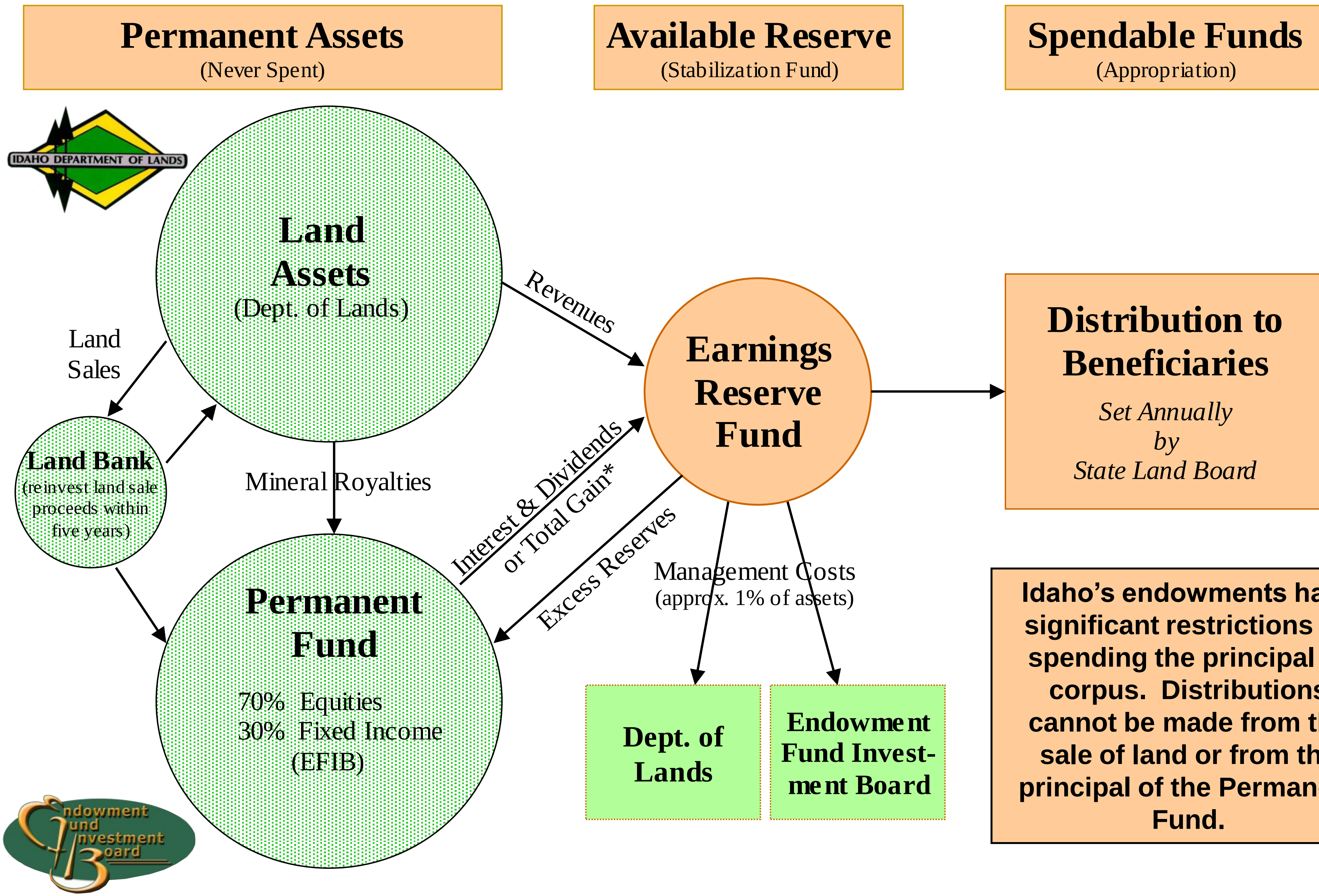
The rate at which an endowment can make distributions depends on:

- Actual and expected return on its fund
- Actual and expected income from its land
- Volatility of fund and land income
- Beneficiary's ability to tolerate declines in distributions
- Need for inflation/purchasing power protection (current vs. future income needs)
- Restrictions on spending principal
- Size of spendable reserves

Spending Policy Strategic Objectives (Adopted by EFIB 1/15/07)

1. Avoid reductions in total endowment distributions
2. Distribute approximately 5% of the 3-year moving average value of the Permanent Funds
3. Maintain adequate Earnings Reserves to protect distributions from temporary shortfalls in fund returns and land revenues
4. Grow distributions and the Permanent Funds faster than inflation by recommending transfer of excess Reserves to the Permanent Funds

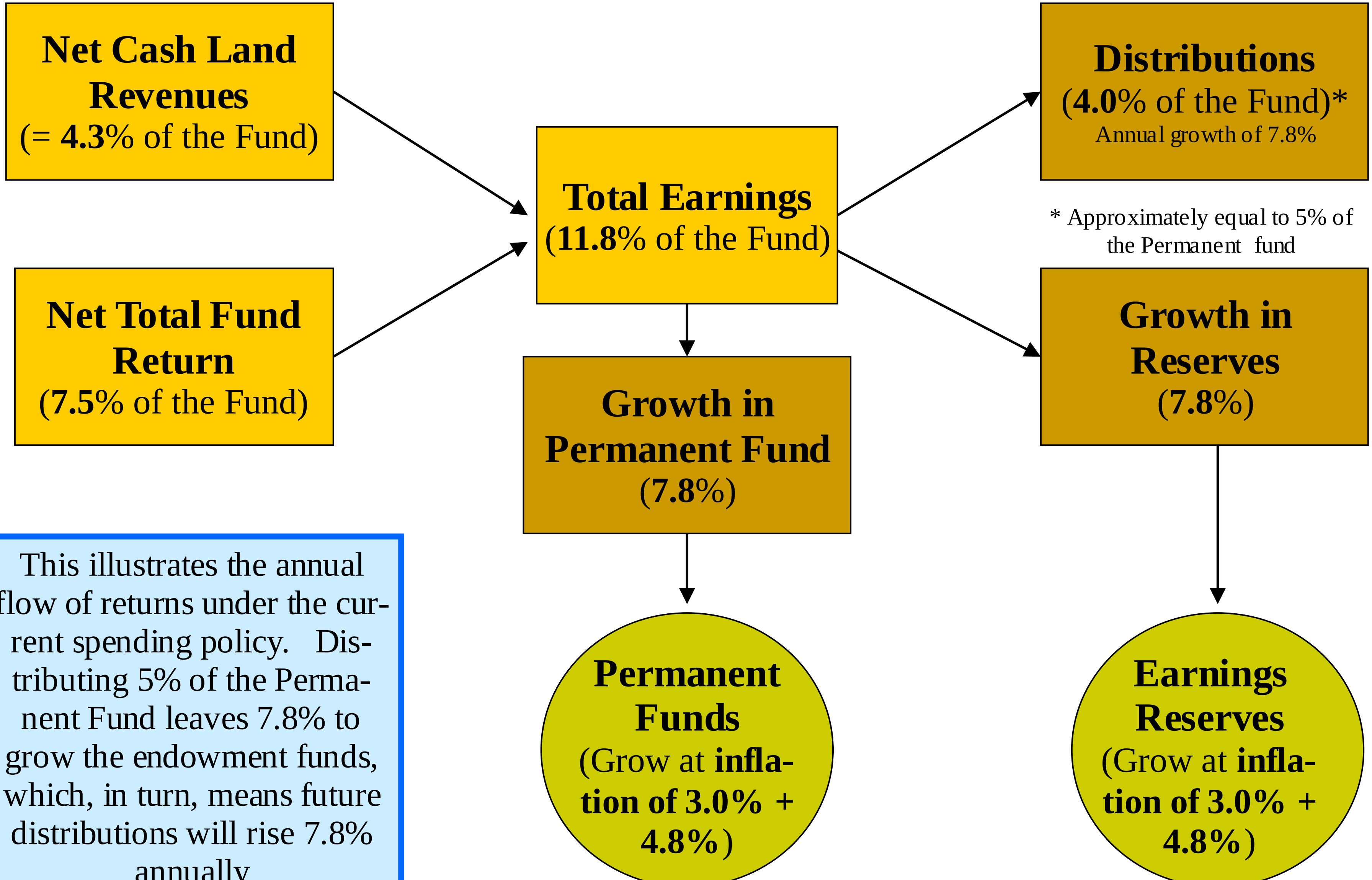
Structure of Idaho's Endowment Assets



Idaho's endowments have significant restrictions on spending the principal or corpus. Distributions cannot be made from the sale of land or from the principal of the Permanent Fund.

** When the Permanent Fund, adjusted for inflation, exceeds its June 2000 level, only total gain over inflation will be distributed to Earnings Reserve.*

Expected Long Term Flow Of Earnings — Total of All Endowments
Distributions = 5% of Permanent Fund = 4% of Total Fund



This illustrates the annual flow of returns under the current spending policy. Distributing 5% of the Permanent Fund leaves 7.8% to grow the endowment funds, which, in turn, means future distributions will rise 7.8% annually

Sources and Uses of Endowment Earnings

	% of the Fund
Expected Endowment Fund Earnings	
Net Fund Return	7.5%
Net Land Cash Revenues	4.3%
Total Earnings	11.8%
Uses of Endowment Fund Earnings	
Distributions*	4.0%
Retain Inflation in the Fund	3.0%
Real Growth in Fund	4.8%
Total Uses of Earnings	11.8%
Expected Annual Real Growth, Above Inflation	
In Distributions	4.8%
In Total Fund Balance	4.8%

* A spending policy of 5% of the Permanent Fund is approximately equal to 4% of the total fund

The endowments, in total, are expected to earn 11.8% per year. Spending 5% of the Permanent Fund is about equal to spending 4% of the total fund, leaving 7.8% per year to offset inflation and provide real growth in the fund and future distributions. As a result, the endowment share of beneficiary budgets is expected to remain the same or grow.

Land revenues for certain endowments vary widely from the 4.3% average

Advantages of the 5% of the permanent fund policy

- Growth in corpus and distributions will probably keep up with or exceed the growth in beneficiaries' funding needs (inflation + population growth +)
- Level of distribution can be funded from either land or portfolio return – does not require both to perform at the same time. Compared to higher spending rates, it:
  - Increases security of distributions over the near term (1-4 years)
  - Requires lower level of reserves
  - Allows more investment risk, meaning higher long-term return
- Pegging spending to the Permanent Fund ties increases in distributions to <u>current</u> beneficiaries to growth in the corpus to protect <u>future</u> beneficiaries

Unresolved issue: What level of reserves is adequate?

- The strategy suggests that when reserves are "adequate", then any excess can be transferred to the Permanent Fund
  - Automatically boosts the distribution (based on 5% of the Permanent Fund)
  - Secures funds for future generations
- However, since distributions can only be made from Earnings Reserve, one must be thoughtful in determining what level is adequate, since any excess that is transferred to the Permanent Fund can never be returned to Earnings Reserve

Next steps

- The EFIB will consider what amount of reserves are adequate at its February and May meetings
  - Preliminary analysis implies several years of distributions may be required to avoid material reductions in distributions thru a reasonably severe market downturn
- Objective: Present detailed Spending Policy to the Land Board in June, obtain approval in July
  - Spending rule (continue with 5% of the 3-year average of the Permanent Fund)
  - Set a level of adequate reserves (several years of distributions?)
  - Policy on transferring excess reserves to the Permanent Fund
- The Spending Policy approved by the Land Board will be a component of the Asset Management Plan

Land Board feedback welcome

- The EFIB is working to flesh out the details of the Spending Policy
- However, ultimately the policy must be approved by the Land Board
- Your questions and feedback are welcome
- We will continue to keep your staff informed of our progress